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Appraising institutional challenges in the early stages of development

Chapter 7: Identifying obstacles to structural transformation: an economic perspective

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François Bourguignon
Paris School of Economics

Jean-Philippe Platteau
University of Namur

Oxford Policy Management
UKaid from the British people
UNIVERSITÉ DE NAMUR
PARIS SCHOOL OF ECONOMICS
ADE Evidence for better policy
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Chapter 7: Identifying obstacles to structural transformation: an economic perspective

7.1 Introduction

Whether in the four case study countries or in the successful development stories of South Korea and Taiwan at the time when they were at a comparable level of income per capita, the issue of development consists of providing the great mass of poor people with either decent jobs or access to other income-generating facilities which can help them to exit poverty. As an overwhelming majority of these poor people operate in the subsistence agricultural sector or other subsistence activities, a central issue of development is the structural transformation of the economy. Such a transformation may take the form of people moving out of agriculture to higher-productivity jobs in metropolises, middle-sized cities, or even so-called cottage industries in the countryside. The structural transformation may also include technological or organisational changes that progressively modify a subsistence agriculture into a market-integrated commercial farming sector exhibiting higher yields and incomes. This chapter summarises what the diagnostic exercises conducted in the four case study countries – Bangladesh, Benin, Mozambique, and Tanzania – reveal regarding the type of economic obstacles that hinder faster structural transformation, and the major institutional weaknesses involved.

A basis of comparison is needed to evaluate the nature and the strength of these obstacles in a particular country. In what follows, this is provided by the benchmark of two of the East Asian tigers, South Korea and Taiwan, considered as they were several decades ago, at the time when the process of their startlingly rapid structural transformation was only just starting. The idea here is not to suggest that the path followed by those development champions could or should be imitated some 40 or 50 years later by today's low-income or lower middle-income countries. Rather, it is to allow for an easier evaluation of obstacles to, and facilitators of, structural transformation by comparing the present situation of the case study countries to the situation prevailing in the two tigers when they were taking off, or shortly thereafter.

With this objective in mind, we proceed in two steps. The first step (Section 7.2) consists of reflecting on the conditions which surrounded the start and then the acceleration of the structural transformation and development in South Korea and Taiwan. One effective way to approach this question is by looking at their performance in the light of the canonical model of 'dual economy development' proposed by Arthur Lewis and amended or refined by other scholars. This approach is especially attractive because the above model has been extensively used to analyse the mechanisms of structural transformation in the two countries. Owing to its relative simplicity, it provides an analytical framework which makes it somewhat easy to identify the contextual factors impinging on the structural transformation of a country. In a second step (Section 7.3), we then consider the main economic obstacles on the path to structural transformation as we can ascertain them in Bangladesh, Benin, Tanzania, and Mozambique, and we offer some first clues about their possible institutional causes.

7.2 The ‘miracles’ of South Korea and Taiwan examined through the lens of the Lewisian framework

As just mentioned, we begin this brief review of the early development of Taiwan and South Korea by recalling the basic mechanisms underlying the structural transformation process as modelled by Lewis and his followers in the ‘dual economy’ tradition.[1] In effect, an important part of the subsequent development literature used the South Korean and Taiwanese early development experiences as good illustrations of this line of development modelling.[2] By laying bare some basic structural transformation mechanisms, our review also supplies a helpful analytical guide to diagnose potential transformative obstacles in other countries.

The dual economy model of Arthur Lewis

The Lewis representation of development is based on an observation which seems universal among countries in the early stages of development: the coexistence of a mass of poor people sharing the income of low-productivity activities in subsistence agriculture or informal retail activities in cities, on the one hand, and modern firms using more productive technologies and paying higher earnings to salaried workers (including for unskilled workers), on the other hand. The ‘dual economy’ model thus distinguishes between a modern or formal sector where capital accumulation is taking place and workers are contracted at some given salary level, and a traditional or informal sector, generally assimilated to family farming but also conceivable as being made up of urban informal activities like retail trade. The marginal productivity of labour in the informal sector is assumed to be small, possibly zero if there is ‘surplus labour’ – meaning that the overall labour force may diminish in that sector without affecting the volume of production. Informal workers therefore receive earnings which, albeit low, are disconnected from the marginal productivity of labour. Various assumptions have been made about the level of these earnings. In Lewis, it is conveniently conceived as customary income which remains constant as long as the marginal productivity of labour in the informal sector is below that obtained in the formal sector.[3] Competition in the labour market across the whole economy implies that the modern sector must pay a wage equal to, or somewhat above, earnings in the informal sector to attract workers, which modern firms can afford thanks to their capital endowment and better technology. These firms thus operate as if faced with what Lewis called, in his famous 1954 paper, an ‘unlimited supply of labour’. In alternative specifications, the wage is exogenously fixed in the modern sector at a level above the average income in the informal sector, which is allowed to vary with the size of the labour force there. Various justifications have been adduced for this assumption of labour market imperfections, in

[1] Lewis' original paper dates back to 1954. Fei and Ranis’s paper (1961) is probably the first and most well-known and influential paper to have extended Lewis's framework. For a review of the huge literature on the dual economy model see Kirkpatrick and Barrientos (2004) and, more recently, Gollin (2014).
[2] See the application of the Fei and Ranis theoretical model to Korea and Taiwan in Fei and Ranis (1975). Note that the relevance of the dual economy framework in explaining the development performance of these countries is not consensual – see the conclusion in Gollin (2014).
[3] Lewis (1968) offered reflections, 14 years later, on the nature of the main assumptions adopted in his original model, suggesting that some of them were not necessary or had been misinterpreted by readers who considered them unrealistic.

particular efficiency wage setting[4] or the imposition of a legal minimum wage in the formal part of the economy.

Within such a framework, development involves a structural transformation of the economy. Capital accumulation in the modern sector leads to proportionate increases in the demand for workers, which help gradually reduce the pool of excess labourers pumped into the informal sector. If accumulation proceeds at a rate faster than population growth, the share of employment and output originating in the informal sector falls with capital accumulation (in the modern sector). This process stops when there is no surplus labour left, or when the marginal productivity of labour in the informal sector has risen enough to catch up with the corresponding productivity in the formal sector. The reserve of labour becomes depleted and competition for workers forces the modern sector to raise its wage rate so as to remain able to attract additional labour force from the informal sector. Instead of being pumped into the latter sector, these additional workers are reallocated to the modern sector. It is then the case that wages increase in both sectors, with the effect of prompting employers to use labour-saving and capital-using techniques.[5]

In this highly simplified description of the development process, the modern sector is the *engine of growth* of the economy and the structural transformation it generates is another way of describing the modernisation of the economy. Practically speaking, however, there are many ways this transformation process may be hindered or even halted. Let us mention a few of them. First, the accumulation rate in the modern sector may not be high enough, or population growth may be too fast, so that the share of employment in the informal sector may fall, with the volume of employment failing to do so. Second, complementary production factors like skilled labour or infrastructure may not be available or may grow too slowly. Third, the same may happen with imported inputs, such as key capital goods, if the capacity to export is insufficient or grows too slowly, unless foreign funds are available. Fourth, (unskilled) labour-saving technology imported from advanced countries may be so effective as to be technically efficient (or technically superior), so that it will be adopted by profit-maximising employers in spite of a relatively low cost of labour.[6] As a result, the labour absorption capacity of the modern sector is reduced.

In addition to structural transformation stalling for the preceding reasons, complications with using Lewis framework may also arise because of the need to amend it so as to accommodate different country contexts. For instance, Lewis stipulates that his theoretical

[4] If the productivity of a worker increases with the wage received, it may be in the interest of formal employers to pay a wage higher than in the informal sector, whereas income sharing in the informal sector would prevent such behaviour.

[5] Alternatively, if wages are exogenously fixed in the modern sector and earnings in the informal sector are determined by the average productivity of labour, the latter will increase as soon as some workers start leaving this sector for the modern sector. The unlimited supply of labour will then vanish when the average product of labour in the informal sector reaches the exogenously fixed wage in the modern sector.

[6] A technology is technically efficient or superior when less capital and less labour is needed to produce the same level of output than with any available alternative technology, regardless of the ratio of input relative prices. Moreover, analogously with technologies, a product is technically efficient (or superior) if it exhibits the best performance in all the dimensions that matter to define its quality (for a car, for example, not only the speed at which it can move, but also the energy it uses up, the resistance of its body to bad roads, etc.). If the superior product is associated with a relatively capital-intensive technology, which is plausible if the product possesses a number of characteristics that make it suited for rich countries, firm managers in developing countries will also adopt the capital-using production process even though it does not match their resource endowments (for a discussion of the difference between the concepts of technical efficiency and economic efficiency, see Sen (1975: Chaps 1–5); for an extension to products, see Stewart (1977: Chap. 1)).

framework is adapted to 'overpopulated' countries where land is scarce and fully used, and labour in the agricultural subsistence sector is likely to be redundant. The situation is expected to be different in countries where land is abundant. Yet, because of imperfect market integration caused by deficient transport and communication infrastructure, lack of access to adequate technology or inputs, or the presence of institutional factors responsible for inefficient land allocation, farming may remain a low-income-earning activity in spite of its rich potential. Characteristically, such a situation will be reflected in the under-utilisation of both land and labour.[7] Structural transformation from low-productivity agriculture to higher-productivity sectors would then remain a possible development strategy, although the promotion of a more efficient use of available land and a dynamic agriculture forms another strategy for development-friendly structural transformation. In the latter case, thanks to the removal of barriers to agricultural expansion, notably the physical isolation of remote areas, subsistence farming would be transformed into a commercially integrated sector oriented towards domestic and/or foreign markets. It nevertheless needs to be remarked that, in the context of sparsely populated countries, the high per unit cost of connecting isolated areas in terms of providing not only transport and communication links but also social amenities, schools, health centres, and various agricultural support services, may lead to the second strategy being deemed inferior to the first one.[8]

Other complications in the original model could also motivate development strategies based on the transformation of the informal sector. They may arise when the demand side of the economy is taken into account[9] – for instance, the demand for agricultural goods, including foreign demand, and the capacity of the country to export or compete with imports of agricultural and non-agricultural goods, including natural resources. However, not enough space is available to cover these complications here.

Despite its apparent simplicity, the Lewisian framework, as well as its extensions or variations in the development theory literature, offer a most useful guide to the understanding of a development process viewed through the lens of the structural transformation of the economy and the constraints weighing on it. This of course requires that the framework is sufficiently enlarged to fit the specific features of the country examined. As will now be seen, it is quite remarkable that the general dynamics of the model, suitably adapted to the context, have proven to be appropriate to describe the successful early development of East Asian countries such as South Korea and Taiwan, despite noticeable differences between the development models of these two countries themselves. In this perspective, the analysis is restricted to the period from the mid-1950s to the mid-1970s, during which both countries would have been classified as low- or middle-income according to today’s international income scale. The differences stem from the initial conditions, the pattern of structural transformation, and some major policy orientations associated with this pattern.

[7] On the way population density and population growth in land-abundant economies affect the nature of agricultural institutions, backwardness, and lack of commercial integration, and lead to economic dualism, see Binswanger and McIntire (1987) and Binswanger *et al*. (1989).
[8] For an extensive discussion of this vicious circle, see Platteau (2000: chap. 2) (see also Delgado, 1992).
[9] See Bourguignon (1990) for a fully specified general equilibrium model of a dual economy with flexible output prices and wage indexation in the modern sector. The possibility of concomitant under-utilisation of land and labour is at the heart of the vent-for-surplus theory of Adam Smith, which was revived by Hla Myint (1958).

Back in the early to mid-1950s both countries had a level of real GDP per capita around US$ 1,400 at international prices in 2017 – see Table 1. Taiwan had a slightly higher level of income than South Korea, and its share of GDP originating in agriculture, generally considered in the development literature as the main component of the informal sector and the reserve of surplus labour in the dual economy model, was then lower. Both on the aggregate and from a structural development point of view, Taiwan was thus slightly more advanced. In the two countries, however, the structural transformation in the following 20 years was astounding. The GDP share of agriculture went down by 25 percentage points in both South Korea and Taiwan, while the GDP share of manufacturing increased by 25 percentage points in Taiwan and 15 percentage points in South Korea. It is more difficult to conduct the same calculation for employment because available data are not comparable across the two countries.[10] Nonetheless, it has been estimated that, helped by a slowing down of population growth, both countries reached the Lewisian turning point – at which the absolute volume of employment in agriculture starts declining – at about the same moment, in the early 1970s. By 1980, the GDP share of the industrial sector was as high as 45% in Taiwan and 33% in South Korea – in both cases, a high level by today's standards. In the two countries, the dynamics of structural transformation by which low-productivity workers in agriculture and elsewhere in the economy were progressively absorbed into the growing modern sector of the economy, including manufacturing, thus appeared to work according to Lewisian predictions predicated on an extremely fast accumulation rate of capital in the latter sector. If manufacturing export-driven expansion was a powerful engine of growth in the two countries, however, there were clear differences in the way it was activated and then sustained, and, as a matter of fact, in the way the Lewisian logic unfolded.

Taiwan

In the case of Taiwan, the expansion of the manufacturing sector relied on a dynamic group of small and medium-sized enterprises (SME), a sizeable proportion of them located in the rural sector and functioning symbiotically with an agricultural sector that was stimulated by a radical land reform and vigorous accompanying policies.[11] The early emphasis on, and dynamism of, the agricultural sector in Taiwan are worth emphasising. They constitute a departure from the straight structural transformation model where overall productivity gains result from the mere sectoral shift of labour from agriculture to industry. Here, productivity gains within agriculture contributed to the aggregate gain too. In any case, both in rural and urban areas, the SMEs provided rising employment opportunities to surplus agricultural workers, who were absorbed in labour-intensive manufacturing activities directed towards the domestic market in a first stage, and then increasingly towards foreign markets.

The SMEs were incentivised to export by a set of policies which included a favourable exchange rate reform – a 60% devaluation between 1958 and 1961 – and tariff relief for imported equipment and other inputs. The whole sector was highly competitive and financially autonomous in the sense that it could rely on internally generated savings and on a limited private credit market, rather than on state bank credit.[12] Quickly, a whole network formed, made up of SMEs buying and selling from each other in a highly efficient way. On the other hand, large firms, which were inherited from the era of Japanese colonisation and

[10] The preceding figures are drawn from Chen (2001).
[11] See Park and Johnston (1995).
[12] See Chu (1999).

then nationalised, also contributed to the production and export of manufactured goods. Yet they proved less dynamic than the private sector, which made big strides forward thanks to its expanding network of SMEs.

At the macro level, it bears emphasis that US assistance played a huge role in the early stage of Taiwan's development, covering as much as about 25% of public expenditures in the 1950s. However, as the Taipei government faced huge defence expenditures during that period, it is not clear how much foreign aid contributed to bridging the trade balance gap. What is certain, however, is that the trade balance regained an equilibrium position as early as 1963, and non-military US aid fell drastically after 1965.[13] The price stability achieved during these two decades, and later, is another achievement that needs to be stressed.

In short, the dramatic structural transformation of Taiwan from the mid-1950s to the mid-1970s relied on a powerful industrial export growth engine, which relied on the dynamism of a network of SMEs enjoying various favourable conditions: a stable macroeconomic context, undistorted prices and competitive market mechanisms, and a sound regulatory policy. The SMEs were also helped by several initial conditions: a) an efficient agricultural sector and prior export experience in agricultural products, obtained during the colonial period; b) a dense transportation network, again inherited from the Japanese colonial era; c) a literate labour force and a population eager to achieve educational progress, so that an increasing supply of skilled labour became available when it was needed later on in the development process; and d) a relative advantage in gaining access to the US and Japanese markets. From the network of SMEs progressively emerged larger companies which would take on the next stage of industrialisation with more capital- and technology-intensive lines of production and exports.

In 20 years, Taiwan was able to multiply its income per capita by three, thanks to an average growth rate close to 6%. What is remarkable, moreover, is the fact that this fast growth and the phenomenal structural transformation of the economy could be achieved with apparently no change, and possibly a drop, in the degree of inequality of the distribution of income. In other words, all people saw their living standard grow in the same proportion, and possibly those at the bottom of the distribution more than others.

As a final observation, it should be stressed that if Taiwan's process of development followed the Lewisian pattern of a rapidly growing, self-financing labour-intensive modern sector which absorbed low-productivity workers from agriculture, it differed from it in one major respect. Instead of being confined to the passive role of a provider of cheap (excess) labour to the modern urban sector, the traditional informal sector, here equated to the rural sector, itself actively participated in labour surplus absorption, capital accumulation, and productivity growth. This was the result of an early modernisation of agriculture, both in terms of techniques and crop choices, and of a uniquely successful programme of rural industrialisation (unique, if we except Japan). In short, dualism in Taiwan was reduced rather rapidly both through productivity gains of the lagging sector and the rising employment share of industry.

Another point which bears emphasis, yet tends to be underplayed in the dual economy literature, is the export orientation of Taiwanese development, without which, most plausibly,

[13] For details on US aid in the 1950s and early 1960s, see Chang (1965).

the country could not have undergone the drastic structural transformation it actually experienced. This feature prevented domestic demand, the size of which was limited, from forming an obstacle to the exploitation of economies of scale and the growth of the manufacturing sector. It is evident that the export sector had to become internationally competitive in a few lines of products.

South Korea

The same structural transformation engine operated in South Korea, where several initial conditions were shared with Taiwan, some of which originated in their common past as Japanese colonies. These included a competent and disciplined bureaucracy, an early progressive land reform made possible by decolonisation, a relatively advanced educational system, and a population eager to learn and to acquire advanced skills. However, compared to Taiwan, South Korea had less developed infrastructure, partly because the core of economic activity before separation was located in the North of the peninsula. What deserves to be underlined is that the patterns of the structural transformation and the policies mobilised to activate the industrial export engine were substantially different in South Korea from those used in Taiwan. If the development path was similar, the engine was somewhat different, and it was activated later.

The real start of the South Korean structural transformation can be dated back to 1961 when a military junta led by General Park Chung Hee seized power, soon morphing into a civilian regime, in 1963. The period between the end of the Korean war and the coup was rather chaotic, with slow growth and intense rent-seeking activity based on import licensing or preferential tariffs. Some existing or new business groups exploited these opportunities, while others developed some limited import substitution activity.

It was under the leadership of General Park and his expert team that the export-led manufacturing strategy was launched. In their vision, there was no future for development based on import substitution because this was bound to be constrained by a domestic market of limited size, due to the low (initial) income of the population. By contrast, a labour-intensive manufacturing export strategy could expand the size of the market, provided that domestic producers succeeded in becoming internationally competitive. Like in Taiwan, this could be achieved through a favourable exchange rate and duty-free imports of equipment and intermediated goods. Unlike in Taiwan, however, the strategy also included generous credit allocation at a liberally subsidised interest rate and state-guaranteed foreign loans. To make these incentives effective, they were granted conditionally to exporters who complied with targets set in agreement with the ministries or state agencies in charge of the export strategy and in conformity with the Development Plan. The management of such a system required a competent bureaucracy that could closely monitor the various export ventures undertaken mostly by business groups that emerged in the previous period. It also required complete control of the credit system, which had been made possible by the early nationalisation of the entire banking system. The strength of the industrial export engine thus depended not only on the dynamism of business groups but also on the volume of resources made available to them, the nature of their conditionality, and their effective monitoring by a competent and non-corrupt bureaucracy.

Since the saving capacity of the country was initially very limited, accumulation at the aggregate level had to rely on foreign funding. Most resources were initially provided by US official assistance. Domestic savings increased rapidly, partly through forced savings policies. However, because accumulation was accelerating too, foreign funding was still needed. After 1965, this consisted mostly of foreign loans so that the external debt of the country started to rise. Yet because of the fast rate of GDP growth, it was possible to maintain the debt to GDP ratio at sustainable levels. Within the country, moreover, the expansion of credit facilities to exporters was responsible for a high level of money creation and a high rate of inflation. The method chosen was thus to (implicitly) tax households and to relax the constraints on the public budget, which had been made tighter as a result of the heavy public investments in infrastructure.

The strategy worked well. South Korea grew very quickly from the early 1960s onwards, while the manufacturing sector and its forward and backward linkages absorbed an increasing proportion of surplus agricultural workers in a typically Lewisian manner. Unlike in Taiwan, however, the agricultural sector was rather passive in the initial stages of development. It was only in the second stage, and in view of the growing development asymmetry between the rural and urban sectors, that specific efforts were made in favour of agriculture and rural areas, through extension services, building infrastructure, and the creation of special industrial zones in rural regions.

It would have been possible to pursue this labour-intensive manufacturing export strategy and, as a matter of fact, exports of clothes, wigs, footwear, and plywood continued to increase at a fast pace and to diversify for an additional decade or so. Yet Park thought that the prospects of such a growth path were limited and that, like in Japan, investment in heavy industry should take over from light manufacturing without waiting any longer. To a large extent against the advice of experts and advisers, he then embarked on the heavy and chemicals industry (HCI) programme. At the same time, and possibly linked to that controversial decision, he strengthened his grip on South Korean civil society by imposing a new constitution that granted him quasi-dictatorial powers.

The HCI programme was implemented through two channels. First, a state-owned enterprise (SOE) was created which would be responsible for creating a giant steel production unit. This strategy was similar to the one followed in Taiwan, where, as a legacy of Japanese colonisation, a group of nationalised enterprises were specialised in heavy industrial production, but it was to some extent bolder in South Korea because of the lack of experience of the country in this line of production and the huge, planned size of the venture. Second, big business groups, known as *chaebols*, which had emerged in the previous phase of the export-led growth strategy, were tasked with undertaking heavy manufacturing export ventures. Towards that purpose, they benefited from considerably enlarged incentives, notably in terms of subsidised credit allocation and foreign borrowing, when compared to those offered to light manufacturing exporters. They were also closely monitored by the executive through a kind of tournament system by which *chaebols* were forced to compete with each other in pursuing a given heavy manufacturing export line.

Against the expectations of many observers, and possibly because of the savvy control exercised over the *chaebols*, Park's HCI gamble succeeded. Among the most outstanding successes was the setting up of shipyards able to build tankers and other heavy vessels for

foreign marine transport companies as soon as in 1974. Meanwhile, the steel producing SOE started operations in 1972.

The achievement of the production and export targets of the HCI programme entailed a high social cost, however. Not only were the incentives provided to *chaebols* especially important, but also investment failures were not infrequent: against the rules initially set, some *chaebols* had to be bailed out by the state, essentially because they were 'too big to fail'. There was thus a double burden on the national budget, and foreign debt rapidly increased. When the second oil price boom hit in 1979, the year President Park was assassinated, the macroeconomic situation became critical. The government nevertheless succeeded in ending the crisis, and in restructuring the *chaebol* network so as to put them on sounder financial grounds. At that time, the structural transformation of the country was complete, and South Korea was quickly advancing on the path to becoming an industrial country.

Such were the early development experiences of the two East Asian tigers, South Korea and Taiwan, at a time when their income levels and their formal-informal structures were comparable to those presently found in the low-income or lower middle-income countries which we selected for intensive study. Relying on our previous analysis, we now set off on the following exercise: to summarise the features specific to those latter countries that could either enable them to pursue a similar path towards structural transformation, possibly at a different pace and according to somewhat different patterns, or derail their development process and perhaps drive them into a deadlock.

7.3 Obstacles to and enablers of structural transformation in the four case study countries

In this section of the chapter, we consider each case study in turn, emphasising the major institutional weaknesses behind the identified obstacles and enablers. A concluding section gathers together the traits that these diagnostics have in common and the traits that appear to be country specific.

Bangladesh: uncertain sustainability of the structural transformation process

In 2018, Bangladesh had the same level of income per capita (in international 2011 US dollars) as Taiwan in 1970 (and South Korea in 1975, see Table 1). Interestingly, the sectoral structure of its economy was also similar. The agricultural sector represented 14% of GDP and 40% of total employment, whereas these figures were respectively 16% and 37% in 1970 Taiwan. However, with a GDP share of manufacturing of 18%, it was well below Taiwan in 1970.

It is most probably the case that the Lewisian turning point has been passed in Bangladesh, but not necessarily because of the absorption of surplus or low-productivity labour by the manufacturing sector and other formal sectors, such as happened among the East Asian tigers. It is true that the labour force involved in agriculture has been declining over the last 20 years, and perhaps a little more, but this is in large part because of a sizeable migrant worker outflow. Thus, an estimated 10 million Bangladeshis were working abroad in 2019. Judging from the evolution of the value of remittances, the total net outflow of migrant workers may have summed up to 9 million people over the last three decades, much more

than the observed drop in agricultural employment. This means that, absent migration, agricultural employment would have been increasing throughout the period. In short, the growth of the other sectors, manufacturing in particular, would not have been fast enough to absorb all the labour surplus by now.

Of course, migration also contributed to economic growth via worker remittances in foreign currency and induced demand effects on the domestic economy. If the overall growth of the Bangladeshi economy has been rather satisfactory over the last three decades, at close to 6% a year and 4.4% per capita, it has partly stemmed from the increasing flow of migrant remittances. It was estimated in Raihan and Bourguignon (2020) that the growth of remittances contributed to a fourth of overall GDP growth between 2000 and 2018. Yet this observation about the significant role of remittances as a source of national growth raises two issues: can we consider the sending of a sizeable portion of a country's population to work abroad a development strategy, and to what extent is it sustainable in the long run? Relatedly, there is a social cost in migration, even when it is temporary, and this must be taken into account.

As in the case of South Korea and Taiwan, the major contribution to the overall growth of the economy and its structural transformation has come from manufacturing exports, mostly ready-made garments (RMG). This contribution has been estimated to be as high as 40% of GDP growth by Raihan and Bourguignon (2020). In this respect, the situation of Bangladesh would seem to compare well to the early development of the newly industrialised countries in Southeast Asia, except for the fact that the share of manufacturing and manufacturing exports in GDP is still far below the levels reached by those countries at the same stage of development. Moreover, manufacturing has grown more slowly, so that it has had less of an impact on the absorption of lower-productivity agricultural labour. Also, it has exhibited a much lower rate of diversification.

Limited manufacturing export diversity, within the RMG sector itself or within a wider definition of labour-intensive exports, is indeed a major conclusion of the economic diagnostic of Bangladesh. The development of the RMG sector in that country owes much to opportunities that arose from the Multifibre Agreement (MFA), which set a quota for Bangladeshi exports, and then at the end of the Agreement, when Bangladeshi exports proved more competitive than those of other countries, then similarly unprotected by the quota system. Dynamic entrepreneurs in Bangladesh seized the opportunity provided by the MFA to convince the government to grant them incentives like those provided in South Korea and Taiwan some time earlier. Simultaneously, they sought the technical support of Korean exporters to improve their international competitiveness. Their gamble succeeded, and a huge network of firms, including SMEs and larger firms, emerged and became part of global supply chains. A potential problem, however, is that this network has become relatively too big, with the effect of pre-empting the development of other sectors and monopolising public financial support and the allocation of credit by an otherwise dysfunctional and corrupt banking sector. In this regard, it is worth noting that this domination by the RMG sector over the Bangladeshi economy is in contradiction with the official Development Plans, which, for some time now, have prescribed diversification of the country’s manufacturing exports.

In summary, there is a risk that, even though it has been rather effective over the last two or three decades, the structural transformation engine of the Bangladeshi economy will slow

down in the close future. This will be the case if the RMG sector is not able to increase its global market share or expand the scope of its activity, or else if it is not supplemented by other lines of labour-intensive manufacturing export. The first option would require a substantial improvement of the competitiveness of the RMG sector, which has relied until now mostly on the low cost of labour and poor working conditions imposed through the co-option of trade unions. Enhanced RMG competitiveness or diversification of the export manufacturing sector requires progress to be made in various areas: (i) better infrastructure in a country where land is scarce – a priority that is acknowledged by the present government; (ii) a more educated and skilled labour force, not only in quantity but also in quality terms, which requires significant progress on the latter; (iii) the laying down of clear and well-thought-out development policies, and the setting of an effective bureaucracy apparatus to implement them; and (iv) an efficient and non-corrupt financial system. It is not clear, at this stage, that all of these requirements for the pursuit of an autonomous development strategy, possibly one that is less reliant on migration, are or will soon be met.

Tanzania: an uncertain growth engine

The economic diagnostic is similar in Tanzania. Growth has proceeded at a rather satisfactory rate of 6% annually over the last 20 years or so, but population growth has curtailed that rate by a little less than half when considering GDP per capita. The problem is that, judging from the last two decades, the sources of future growth and/or their sustainability are uncertain. It is true that the GDP share of the agricultural sector has declined by some 12 percentage points, starting from a high 40%, while its share of employment has decreased by 14 percentage points, down to a still high level of 70% today. This could suggest that a strong structural transformation is under way. This being said, only a small fraction of the GDP loss of agriculture has gone to manufacturing. More than half of the reallocated agricultural workers have gone to the construction sector, whereas most of them have been employed in trade and hospitality services. In addition, labour productivity has drastically fallen in these services relative to the rest of the economy, the same being true, albeit to a lesser extent, of manufacturing activities. Such an evolution is hardly consistent with a powerful engine of growth moving low-productivity agricultural workers to higher-productivity jobs in the rest of the economy. It resembles more a process of demand-driven growth where income gains, partly stemming from the expansion of mining (gold) and favourable changes in the terms of trade, are spent on domestic production, including construction investments and services.

Although limited, the relatively fast growth of output and employment in the manufacturing sector sends a positive signal in respect of structural transformation and economic dynamism. That it has come with a significant expansion of labour-intensive manufacturing exports is especially encouraging. But it is still too slow, and the sector is not large enough to have a major impact overall. There was also some promising progress in tourism before the COVID-19 pandemic struck. The fact remains, however, that a growth process largely based on mining exports and/or favourable international prices cannot be considered as sustainable in the long run.

All in all, this sectoral evolution, combined with fast population growth, has caused the number of people operating in the agricultural sector and contributing to the labour surplus to keep increasing at a high pace. This does not mean that the Lewisian structural

transformation mechanism has not been at work. As a matter of fact, the reallocation of some of the labour force from low-productivity agriculture to the rest of the economy, including the informal trade sector, despite its relatively low level of productivity, has contributed to overall growth and has reduced the output and employment share of the agricultural subsistence sector. The reallocation process is simply not fast enough, and population rises are too quick, to prevent low-productivity employment from continuing to grow both in agriculture and in informal non-agricultural activities. This conclusion also applies to the informal trade sector and, most likely, to other sectors of the economy too.

When considering informal agriculture, there is an important proviso that needs to be brought to bear on the preceding argument: as we have already pointed out, the Lewisian model presupposes the full utilisation of land in the context of densely populated countries, and it is in this specific context that the concept of an unlimited labour supply in the rest of the economy makes sense. In most African countries, including Tanzania, Benin, and Mozambique in the present project, this condition does not seem to be satisfied, so that rural population might theoretically grow without a fall in labour productivity. If it does so, the structural transformation would pass through an extension of the agricultural sector and agro-industrial development. For this to happen, though, some flexibility would be required in the use of land resources. Owing to institutional dysfunction, this condition seems to be precisely lacking in the case of Tanzania, as will be discussed later in Chapter 9. The implication is that, if the basic dual economy framework remains applicable to a country like Tanzania, the additional option of sparking dynamisation of the rural sector, agriculture in particular, should not be ignored.

The situation of Tanzania today clearly differs from that of Taiwan or South Korea when those countries were at the same level of real income per capita – see Table 1. If the GDP share of agriculture is of the same order, the employment share is much higher in Tanzania, whereas the share of manufacturing in GDP and in employment are substantially smaller. However, it bears emphasis that in 1970, when income per capita in South Korea was comparable to that of Tanzania today, the relative growth of the manufacturing sector and the vigorous manufacturing export strategy in the latter country had only started a few years before. The upshot of this is that the economic structure of Tanzania today closely resembles that of South Korea around 1970. However, the stock of both physical and human capital available to South Korea, as well as its institutional endowments in general, were certainly much more growth-friendly than those in Tanzania, as will be seen below and in the next chapters. Still, with a GDP share of investment above 30%, accumulation is proceeding at a comparatively fast pace in Tanzania. It is therefore possible that the gap in infrastructure between Tanzania and the counterfactual of historical South Korea will shrink in the near future.

The above type of transhistorical comparative exercise should obviously be interpreted with caution. There is no reason to expect history to repeat itself across countries or regions and it would be naïve to believe that the only pathway to development and structural transformation is the one followed some 50 years ago by the East Asian newly industrialising countries. This being acknowledged, the above comparison provides diagnostic insights that can be helpful in gauging, almost mechanically, the development potential of Tanzania, and in highlighting the consequences of a missing engine of long-term growth, at least for now.

Another difference between Tanzania and the East Asian comparators lies in the evolution of inequality. Not surprisingly, the slow decline in the labour surplus and the widespread informality of the economy in Tanzania are bound to have a negative impact on informal earnings, and therefore on inequality and poverty. Thus, available evidence suggests that inequality has tended to increase in the country, whereas the decline in the poverty headcount – i.e. the share of the population below the poverty line – has slowed down over the last few years. Because of the high rate of population growth, however, the number of poor people has kept increasing.

Slowing down population growth is, by all means, needed, but the impact of such a slowdown on the employment situation will take three or four decades to make itself felt. Incentivising labour-intensive manufacturing to make it more competitive in domestic markets as well as in foreign markets, and extending incentives to tourism and agro-industrial exports – two clear comparative advantages of Tanzania – seem to be ways to accelerate growth and the structural transformation of the country's economy. Even with continuing favourable terms of trade, and possibly with the benefit of rents accruing from presently untapped reserves of natural gas, such a development strategy is made necessary by the fact that Tanzania's known natural resource rents are not sufficient to ensure the future prosperity of the country.

There is an issue as to whether such incentivising policies meet international WTO trade rules, which did not exist at the time of the East Asian industrialisation. Measures that are not consistent with those rules, such as the subsidisation of credit, duty exoneration on inputs, and the provision of critical infrastructure, are needed, at least temporarily. The rationale for implementing such measures is that it is not currently clear how internationally competitive Tanzanian firms are, and how they would perform if they were to develop new production lines. A vibrant entrepreneurial elite is no doubt active in Tanzania, yet strong incentives may be needed to persuade them to deviate from prior business models. The monopolistic structure of big swathes of the business sector is also a possible hindrance to shifts in activities.

Clear and appropriate policies, effective administrative management, and the availability of economic resources to implement them, as well as the development of infrastructure, both hard and soft, to improve the competitiveness of Tanzanian firms are required for the success of an ambitious manufacturing and tourism export promotion strategy. On all of these grounds, Tanzania is not well endowed. Policies are often suboptimal. One example is the failure to protect domestic producers against sugar imports. This failure is apparently the result of the decision by the government to favour some private firms at the expense of an integrated domestic sugar industry that is presently unable to compete with imports because of limited scale economies. On the other hand, markets are frequently monopolistic and ineffectively regulated. Long-term development plans are not always realistic, and, in any case, their implementation relies on a weak and reputedly corrupt bureaucracy to carry them out. As far as soft capital accumulation is concerned, progress has been made on the educational front in terms of enrolling nearly all children of schooling age, but learning outcomes remain disappointing. Furthermore, employers regularly complain about the lack of skilled workers. On the side of physical infrastructure, finally, Tanzania was until recently a laggard in energy production and distribution, and ports, roads, and rail transport facilities need to be seriously improved. On that front, however, there is no doubt that the preceding administration has made valuable efforts to improve the situation – in the sectors of

hydropower, railways, roads, and port facilities – despite limited public resources. In this regard, it must be borne in mind that over the last 10 years the average tax rate was below 11% and government savings were near zero, thereby making public investment in infrastructure dependent on foreign funds, including foreign aid and credit.

Excessive financial dependency on foreign countries or organisations is an important economic obstacle to successful structural transformation. Tanzania has always been treated as an 'aid darling', except temporarily after the revelation of major corruption scandals. This has been the case ever since donors imposed, and then supported, the transition to a market economy, which was made necessary by the poor results of the socialist development strategy pursued in the two decades following independence (in the early 1980s). Foreign assistance has continued to account for 5% to 8% of GDP over the last decade, which raises the issue of what would happen to public investments – and even to current expenditures on health – if the volume of aid were to fall in line with the recent announcements made by several donors.

In summary, Tanzania’s growth performance since the turn of the new millennium provides reason to celebrate, although optimism must be tempered. Tanzania is still in the middle of the dualistic stage of development and the problem is whether it has the potential to reach in the foreseeable future the next stage that lies beyond the Lewis turning point. The economic diagnostic suggests that it lacks a clearly identifiable engine of sustainable long-run growth, and, more worryingly, an institutional setup appropriate to meet the challenges ahead. More about these institutional aspects will be said in Chapters 8 and 9.

Benin: seizing informal income opportunities is no substitute for a development strategy

Benin's development over the last few decades has been characterised by modest growth performance and a rather atypical sectoral structure of employment. Although some acceleration has been observed during the last five years, the average annual GDP growth rate has been slightly below 5% since 2000. With an almost 3% rate of growth of the population, income per capita has grown rather slowly, and in any case at a slower pace than in the rest of the continent. Concerning the sectoral structure of the economy, it can be seen in Table 1 that the share of agriculture is of the same order as in South Korea and Taiwan when those economies were at the same level of income, but also that the share of the manufacturing sector is well below that of the Asian tigers. Benin's sectoral structure of GDP is close to that of Tanzania and, as a matter of fact, that of most sub-Saharan low-income or lower middle-income countries. Where Benin is atypical relative to both sub-Saharan countries and the Asian comparator countries, however, is in the structure of employment. It exhibits a substantially smaller proportion of the labour force employed in agriculture – and therefore a higher proportion in other sectors – and a somewhat higher average labour productivity in that sector relative to the whole economy. The latter is partly the consequence of the importance of cotton production and exports in the Beninese economy, even though productivity in this activity has gone through cycles over the last two decades, some of them with clear institutional causes.

The modest rate of growth of the Beninese economy has its roots in an investment rate which has been below 20% over the last 20 years, except in the recent past. With such slow

capital accumulation, labour productivity has hardly progressed within the various sectors of the economy; it has just been sufficient to attract labour away from agriculture. As a matter of fact, the overall growth of GDP owes more to the movement of labour out of low-productivity agriculture than to sectoral productivity gains, except perhaps in agriculture, because of a rather weak population pressure on available land. In effect, productivity has gone down in all non-agricultural sectors due to population growth, limited investment, and the inflow of labour coming from agriculture. This is particularly true of the commerce sector, which is a typical shelter for informal labour.

Because of statistical imprecision, it is not clear whether the absolute volume of employment has gone down in agriculture, or whether it has simply grown more slowly than the whole population. Whichever is the case, a substantial proportion of the rural population has left agricultural activity over the last 20 years, not because of formal employment creation in the rest of the economy, but most likely because of a smaller incidence of poverty outside the rural sector. Nonetheless, poverty is declining slowly and remains high by international standards: 47% of the population was below the international poverty line of US$ 1.95 per person and per day in 2011 purchasing power parity. As for inequality, it is on the rise.

It is tempting to view the transfer of informal employment from agriculture to the rest of the economy as being caused by the largely informal cross-border trade (ICBT) with Nigeria. This is a major peculiarity of the Beninese economy and the consequence, as well as a possible cause, of slow formal development. ICBT was first encouraged by differences in tariff and non-tariff barriers between Nigeria and Benin, which, as a member of the West African Economic and Monetary Union (WAEMU), applies the Union’s rules. These differences create arbitrage opportunities for products legally imported into Benin and re-exported to Nigeria, where they enter illegally, and vice-versa for certain products smuggled illegally from Nigeria, where they are cheaper, into Benin. Such informal – and mostly illegal – trade activity is estimated to account for a little more than 10% of GDP, only slightly less than cotton exports, and to employ directly at least 2% of the labour force, both figures having sizeably increased over the last 10 years.

By itself and through its upward and downward linkages, ICBT has huge effects on the Beninese economy and society. First, it contributes to increasing the incidence of informality, and it tends to nurture a culture of corruption. Informality follows from the illegal nature of the activity, while corruption is used to buy the complicity of state executives and bureaucrats at various levels of the administration (including customs officers), and to obtain credit facilities from banks. This is particularly true for the large-scale smuggling of gas and other materials from Nigeria. Second, ICBT displaces some formal activities and diverts entrepreneurs from potentially more socially profitable formal lines of activity. A series of smuggled products outcompete domestic producers, most notably in gas distribution and cement production. Third, the failure of the state to curb this illegal activity entails a loss of intervention capacity in other areas indirectly affected by the cross-border trade. For instance, incentives to develop other activities are rendered inoperative, despite the presence of a dynamic entrepreneurial class. Fourth, at the macro level, illegal trade with Nigeria makes Benin dependent on the former's oil revenues and subject to oil price fluctuations in international markets. The macroeconomic shortcomings of this dependence are well-known, especially for a country which has adopted a fixed exchange rate system.

Cross-border trade with Nigeria is a revenue-generating opportunity and it is natural that some entrepreneurs seized it. Yet its overall contribution to development may end up being negative, because of the informality and the culture of corruption that it has brought about, the uncontrolled smuggling that it has triggered, its unsustainability, and the marked dependence that it has created vis-à-vis Nigeria's trade policy. The fact that Nigeria recently decided to close the border, and has effectively stuck to that decision, is a sore reminder of this crude reality.

As mentioned earlier, cotton is the main formal activity in Benin, representing 12% of GDP, and providing most of the country's formal export revenues. The organisation of the whole sector, and the respective roles of the private and public sectors, have gone through several changes over time, with direct effects on production and exports. Except for farming, the whole chain of production is structured as a monopoly and has been very much under the control of a single business group, headed by Patrice Talon, an entrepreneur who was elected President of the Republic several years ago and has just been re-elected. The monopolistic structure of the cotton sector necessarily entails significant efficiency costs. It is fair to recognise, however, that the sector has done rather well since its organisation has been stabilised, and this despite the monopolistic organisation of input provision, ginning, and commercialisation.

Since cotton exports or cross-border trade can hardly be conceived as powerful and sustainable vectors of development, it must be acknowledged that there is no engine of growth presently at work in the Beninese economy, and it is not clear that such an engine is about to be developed. Benin has clear comparative advantages in agriculture, not least because there is plentiful land available, particularly in the northern part of the country, which has been largely neglected by successive governments in Cotonou. Developing agro-industrial exports is a real possibility as some encouraging initial attempts are attesting. However, to push these further and to create an impetus that can spread to other areas and other lines of products requires a better provision of public goods, including a competent and non-corrupt bureaucracy, better infrastructure, more investments in quality schooling, and, most importantly, a clear and consistent development strategy. Although controversial, the present administration seems to be making progress in that direction. But there is still a long way to go before a genuine structural transformation and a definitive dent on poverty can take place in the country.

Mozambique: Natural resources rent as an obstruction to structural transformation

In comparison with other case study countries and *a fortiori* with South Korea and Taiwan, the combination of development advantages and shortcomings in Mozambique is quite specific. First, both its geography and ethnic composition are extremely fragmented. The country extends over 2,300 kilometres from north to south and its population includes 10 main ethnic groups, rather clearly differentiated by geographic region. From the latter point of view, Mozambique would be comparable to Benin, except that the groups are physically more distant from each other, their isolation being amplified by a limited development of transport infrastructure. Second, the country obtained its independence much later than other African countries – as a matter of fact, at the same time as Bangladesh – but it fell quickly into a long civil conflict which paralysed economic development for 15 years. Third,

like other case study countries in the Institutional Diagnostic Project (IDP) project, Mozambique adopted a socialist approach to development at independence, which delivered poor results, especially in the context of the domestic conflict. A transition towards a market economic system was made under the supervision of the international financial institutions, yet it proved more difficult and painful than elsewhere because it was launched at a time when the conflict was not over.

Despite these hindrances, and largely thanks to an unusually high level of foreign development assistance, the Mozambican economy was able to grow at a fast rate until a few years ago. Growth was first triggered by the recovery from the civil war, and it then proceeded via more standard economic mechanisms. GDP per capita has thus grown at a little more than 4% annually since the turn of the new millennium, until 2016, when a major economic crisis struck for reasons which are detailed below.

Statistical data in Mozambique are partial, especially concerning employment. It is thus difficult to conduct a rigorous decomposition of the sources of growth. Yet, from what can be gathered from the evolution of the structure of GDP and employment by broad sectors of activity (i.e. agriculture; industry, mining and construction; others), it appears that over the last two decades, the structural transformation of the economy – by which the employment share of agriculture has fallen in favour of other sectors – has contributed to around half of the overall growth in labour productivity, with the rest resulting from productivity gains within broad sectors of activity, agriculture in particular. Yet the period has been very heterogeneous. Within-sector productivity gains, including in agriculture, dominated in the 2000s, a period during which overall productivity growth proceeded at a high annual rate of 5.6%. By contrast, structural transformation through changes in sectoral employment shares has proved more important in the last 10 years. However, as for Benin, the mechanism behind these changes is unclear.

Growth in manufacturing cannot be an explanation. A major part of this growth has actually come from the production of aluminium made possible by the availability of cheap hydroelectric power on the Zambezi River. But this activity, very much akin to the exportation of natural resources, employs only a small number of workers and has limited linkages with the rest of the economy. Since its capacity has not expanded, and since few other lines of manufacturing activity have developed over the last 20 years, the GDP share of the manufacturing sector has fallen continuously over this period. As a result, the limited structural transformation away (from agricultural employment) that has taken place in Mozambique has occurred predominantly to the benefit of low-productivity services, informal retail trade in particular.

Over the last decade, the dynamic part of the Mozambican economy has been the extraction of coal and natural gas. The latter is expected to expand drastically in the future when the huge reserves discovered in 2010 will enter into full exploitation. Together with aluminium and electricity sales to neighbouring countries, coal and natural gas represent today some 70% of total exports and their share of GDP may be estimated at around 12%.

It is thus fair to say that Mozambique has become an exporter of natural resources and has tended to live on the related rent over the last few years. This explains why slow progress has lately been made in the production of tradeable goods, as the largest part of domestic growth has been accommodating the rent-based increase in the aggregate demand for non-

tradeables. The structure of Mozambican development has thus radically changed between the first and the second decades of this century. Quite telling in this respect is the fact that both agricultural and manufacturing output per capita have stagnated since 2010, and even somewhat earlier for manufacturing.

A possible reason for the lack of dynamism of the manufacturing sector is the absence of an entrepreneurial class in Mozambique. At the time of the planned economy after independence, bureaucrats oversaw the production apparatus, as Portuguese entrepreneurs had left the country. When the transition to a market economy took place a little before the end of the civil conflict, production units were privatised in favour of political personnel with little or no business experience and relying more on political connections and rent creation than commercial flair. Now that the country can live on the rent arising from natural resources, incentives for the appearance of an ambitious class of industrial entrepreneurs are weak and might become even weaker in the future. The demand arising from the rent will be mostly addressed to domestically oriented sectors like services and construction and, presumably, it will mostly benefit the urban part of the country, and Maputo, the capital city, in particular.

The prospect of huge rents related to the future exploitation of natural gas has also exacerbated the appetite of rent-seekers and revealed the extent of corruption in Mozambique, at the same time as the ineffectiveness of the state apparatus to control it. A scandal struck in 2016 when it appeared that a few years before, a US$ 2 billion loan had been contracted by senior officials to invest in a shipbuilding, fishing, and maritime surveillance project. As it turned out, most of the money had been used for an opaque arrangement aimed at feeding a system of corruption that directly or indirectly involved high-ranking figures within the circle of power. As a result, donors cancelled foreign assistance payments, which plunged Mozambique into a deep financial and economic crisis. Poor growth performance ensued over the next few years, but the worst damage was created by the surging awareness of the pervasiveness of rent-seeking and corrupt practices, and their prevalence over entrepreneurship and bureaucratic effectiveness. It is striking that, in practically all dimensions, the World Governance Indicators have pointed to a pronounced deterioration of the country's governance institutions – see Chapter 2 – as though the prospect of huge rents from natural resource exports had suddenly modified the behaviour of people invested with key responsibilities.

Finally, we need to turn our attention to the agricultural sector and the issue of poverty, which affects more than 60% of the population and is concentrated in rural areas. Given that the present and future engine of growth is natural resources whose exploitation is based on capital-intensive techniques, there is little hope for a quick absorption of low-productivity agricultural labour and for rapid advances on the poverty front. A slowdown in labour absorption and the concomitant increase in the degree of income inequality are already perceptible when we compare the last two household surveys. The situation is made still worse by the geographic extension and the ethnic fragmentation of the country. Combined with largely insufficient and inefficient transport infrastructure, both factors reduce labour mobility and limit the gains that could be obtained from inter-regional trade. An important challenge that Mozambique will face in the future thus lies in its capacity to use its forthcoming rents from gas exports to boost the traditional agricultural sector. This alternative to industrial development as the main engine of structural transformation, which befits land-abundant countries, must quickly gain the attention of Mozambican policymakers

if they want to make a real dent in poverty and to establish a broader base for the country's development. After all, agricultural productivity increased at a rather fast pace in the first decade of this century, when the recovery from civil war times was most likely completed. Efforts should be made to revive such a trend while avoiding Dutch disease phenomena, which will unavoidably manifest themselves as natural resource exports increase.

In summary, the key development issue in Mozambique is whether existing institutions and the structure of political power will allow a structural transformation of the country that will simultaneously absorb part of rural labour, increase agricultural productivity, and expand local markets through a deeper physical integration of the country. The recent evolution of the economy and the reappearance of social and political tensions, including recent terrorist attacks in the coastal area facing the offshore gas fields, are worrying in this regard. Moreover, foreign donors have reduced their interventions, partly due to recent scandals and mounting corruption, and partly as a result of the growing belief among Mozambican political elites that the forthcoming natural resource rents will relieve them of the need to call on foreign support. This is a potential problem not so much because potential flows of financial resources will thereby be lost, but because the advice and expertise which accompany them will also be lost.

7.4 Conclusion

Several conclusions can be drawn from the preceding summary diagnostic of economic impediments to long-run structural transformation in the countries covered by the IDP. These seem general enough to be of relevance for other low-income or lower middle-income countries.

First, even though the ultimate objective is to identify institutional obstacles to development, the identification of economic obstacles is an absolute prerequisite. The reason for this is that institutions may prevent the removal of economic barriers, which may themselves be obstacles to development. In such a perspective, it is essential to define economic development as the long-run structural transformation of the economy and the society, rather than GDP growth per se. It has frequently been observed that economic growth can temporarily accelerate thanks to favourable circumstances, typically sparked by rising prices in international markets, but that this is not translated into a lasting impact on the structure of the economy and the roots of poverty.

Second, despite the preceding point, the concept of a 'growth engine' is essential in the sense of a dynamic force applied to some part of the economy with the power of moving other parts up. The strength of the engine and the quality of the transmission belts are the crucial determinants of development. Thinking in terms of a growth engine and the structural transformation approach has proven its usefulness in the diverse economic diagnostics summarised in this chapter. In short, we have detected the following: in South Korea and Taiwan, the operation of strong manufacturing export-led engines in the early phase of development, when these two countries could be qualified as low-income according to today's classification; in Bangladesh, the presence of a similar type of engine, yet with a risk of future idling; in Tanzania, the absence of a powerful growth engine, coupled with significant progress in manufacturing exports and promising potential in other fields, notably tourism and agroindustry; in Benin, the operation of a substitute, but weak and

unsustainable, growth engine based on ICBT, and this despite promising prospects in the agricultural sector; and finally, in Mozambique, the hard challenge faced by the authorities of transforming natural resource rents into a structural transformation engine.

The usefulness of the comparative approach in establishing the diagnostic of a country, particularly against the successful Asian development stories in their early days, must be underscored. Diagnosing without relying on explicit comparison references may indeed lead to ambiguous or weak conclusions. Despite limited comparability due to the natural context and initial conditions, the successful experiences of South Korea and Taiwan, even when considered 50 years after the fact, have the advantage of offering a most helpful benchmark in the light of which judgements can be made about the potential of other economies to develop with the same dynamism, albeit along different lines.

Third, the identification, and then the sparking and the maintenance, of a growth engine require the designing and effective implementation of a clear state-managed development strategy. The provision of essential public goods and services for business activity is an absolute necessity. But it is unlikely to be sufficient. The presence of numerous market failures, of scale economies which cannot be exploited in domestic markets, or of sunk costs which slow down the adoption of new technologies or the opening up to foreign markets, require more than such a minimal approach. In this respect, the industrial policy followed by the Asian tigers is telling, as is the support brought by the state to the RMG sector in Bangladesh, and they contrast with what is observed in the other countries. To be sure, 'development plans' are ubiquitous in the developing world, but they are not always well and realistically designed, and their implementation is often ineffective.

The design and implementation of such state-led development strategies require well-functioning institutions, and this is where serious institutional obstacles are likely to appear. They will be analysed in depth in the next two chapters, but it is hard to deny that a competent and non-corrupt bureaucracy, as well as the quality of the political leadership, including its relationship with business actors, have been crucial assets in the success of East Asian development strategies.

Fourth, the need for well-thought-out and effective strategies should not conceal the critical role of infrastructure, both hard and soft, in structural transformation. After all, it is because it could rely on a competent and effective bureaucracy, a population with a middle educational level, a dense transport network and power plants – inherited from the Japanese colonial era – that the KMT was able to launch an ambitious development strategy in Taiwan in the early 1950s, despite the country being then almost as poor as Mozambique is today. In South Korea, Park seized power in 1961 in the context of an economy which was as poor, inefficient, and corrupt as several low-income or lower middle-income countries today. However, he could count on a strong bureaucratic apparatus and a sufficient number of highly skilled people to permit the quick elaboration and the rigorous implementation of a bold development strategy. Investments in infrastructure and education thus appear as necessary instruments in order to establish basic initial conditions, so that an effective development strategy can be launched as soon as opportunities arise.

Developing these instruments also calls for institutional prerequisites. The identification of the main obstacles to effective state capacity and the exploration of the role of politics in

establishing and implementing the structural transformation of developing economies are the two central issues addressed in the subsequent chapters.

Table 1. Comparing the development and sectoral economic structures at equivalent levels of GDP per capita of the four IDP case studies and the Southeast Asian tigers

	Mozambique	Taiwan	South Korea	Benin	Taiwan	South Korea	Tanzania	Taiwan	South Korea	Bangladesh	Taiwan	South Korea
Year	**2018**	**1950**	**1955**	**2018**	**1960**	**1965**	**2018**	**1965**	**1970**	**2018**	**1970**	**1975**
Income per capita	1133	1460	1410	2160	2160	1920	2870	2880	2970	4020	4040	4360
Growth rate (10-year average)	3	5.3	2.3	1.4	4.3	6.7	3.1	6.5	8.6	5.3	6.9	7.4
GDP shares (%)												
Agriculture	24.6	36	42.3	27.1	28.5	34.4	27.9	22	27.1	13.1	15.5	23
Industry	23.6	15.6		14.6	26.9		29.5	31.8		28.5	36.8	
Including: manufacturing	8.7		10.9	9.7		16.7	9.1		16.7	17.9		21
Others (incl. services)	51.8	48.4		58.3	44.6		42.6	46.2		58.4	47.7	56
Employment shares (%)												
Agriculture	70.6	56		39.1	50.2	59.4	69.7	43	50.4	40.1	36.7	45.8
Industry	8.2	16.9		18.3	20.5		9.2	24.2		20.5	28	
Including: manufacturing						9.2	3.2		13.2	14.2		18.6
Others (incl. services)	21.2	27.1		42.6	29.3		21.1	32.8		39.4	35.3	